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RE: IEP's Comments on Draft Energy Action Plan II

Dear Ms. Ebke and Mr. Kelly:

The Independent Energy Producers Association (IEP) respectfully submits comments on the draft Energy Action Plan II (draft EAP II). These late filed comments are submitted pursuant to the instructions included in the agenda for the June 15, 2005 Joint Agency Energy Action Plan meeting. IEP's comments are presented in two parts. First, as a general overview, we address broad themes associated with EAP II, which serves as the "implementation plan for state energy policies" developed jointly by the state energy agencies over the past years. Second, we provide comments on specific sections of the draft EAP II.

I. General Overview

IEP supports the general approach in the draft EAP II of fostering improved regulatory certainty by providing an updated roadmap for continuing progress on the major EAP I initiatives announced in EAP I. As noted in the draft EAP II, the EAP II is not intended to develop or present new policy initiatives. The energy agencies, stakeholders, and policymakers have a full plate implementing the directions prescribed in EAP I. Thus, we support the draft's statement that EAP II represents a "refinement and strengthening" of the foundations provided in EAP I. Furthermore, we support acting now on the direction articulated in EAP II to better anticipate California's future needs in a timely manner, avoiding the disruptions associated with regulatory instability

and supporting critical improvements in energy infrastructure. Consistent with these goals, IEP offers specific comments below.

A. Need To Address The TURN Initiative

One of the beneficial features of the EAP I was the extent to which it helped create a measure of direction and regulatory certainty for the energy markets in California. All the state agencies agreed and were working cooperatively toward a common set of outcomes. Presently, an initiative on the November ballot (the TURN Initiative) threatens to completely undermine the direction and regulatory certainty expressed in the EAP I and draft EAP II. Passage of the TURN Initiative will undermine many of the foundational goals and objectives established by the Joint Energy Agencies over the past few years. For example, the TURN Initiative will undermine the following policies and actions contemplated in the draft EAP II:

- **Demand Response:** “Issue decisions on the proposals for statewide installation of advanced metering infrastructure for all small commercial and residential IOU customers by early 2006.” [draft EAP II, at p. 5]
- **Renewables:** “We are analyzing the steps necessary to achieve the Governor Schwarzenegger’s higher renewable standard goal of 33 percent of electricity sales by 2020.” [draft EAP II, at p. 6]
- **Electricity Market Structure:** “Complete and refine, as necessary, the current IOU electricity procurement process to ensure that it is transparent, open, and fair, proceeds in a timely fashion, and achieves California’s resource adequacy requirements.” [draft EAP II, at p. 7]
- **Electricity Market Structure:** “Develop rules that would allow for an effective core/non-core retail market structure, including mechanisms to guard against cost-shifting, preserve reliability, and achieve RPS goals.” [draft EAP II, at p. 7]
- **Electricity Market Structure:** “Work to develop capacity markets, including possible tradable capacity rights and obligations, to create appropriate incentives and flexibility for power plant development.” [draft EAP II, at p. 7]

The TURN Initiative completely disrupts the progress made with respect to California energy markets. If adopted, the TURN Initiative would set back, if not totally reverse, the Joint Energy Agencies’ strategy as embodied in the EAP I of creating an integrated, least-cost, forward-looking, demand-responsive, reliable electric grid. In the past, when energy initiatives such as the TURN Initiative are on the ballot, investment decisions stop; infrastructure development stops; and the opportunity to build from the errors of the past and develop new, reliable infrastructure for California consumers evaporates. Thus, the TURN Initiative is antithetical to the interests of creating and sustaining a measure of regulatory certainty in California, which was a key achievement of the Joint EAP process.

IEP recommends that the Joint Energy Agencies (either collectively or individually) address the TURN Initiative in light of the policy directives of the EAP I and EAP II. What impact the TURN Initiative will have on the timetable for implementing needed energy policy reforms? What effect will the implementation of the

TURN Initiative, and the delay to complete the implementation, have on grid reliability? What effect will the TURN Initiative have on investment in California? The EAP II can and should be a tool to clarify what direction the state agencies desire to take vis-à-vis the TURN Initiative.

B. Need To Address Standards for Achieving Goals of Openness and Transparency

IEP strongly supports the draft EAP II goal of providing “open, transparent, and compelling information and education to all stakeholders and consumers in the State.” This should be a critical objective of each and every state agency promulgating rules, conducting planning, and fostering procurement to ensure a safe and reliable electric grid. A primary goal of the state energy agencies, particularly the regulatory agencies, should be to ensure that all parties to a proceeding have *comparable access* to data from which they may make arguments, offer testimony, or opine on decisions.

Unfortunately, the standard of comparable data access is not applied universally today. As a result, we have an environment in which some Parties have access to information not available to others. This inequality effectively creates the equivalent of “second class citizen” status for some Parties in agency proceedings. Not only does this effect result in less-informed agency decisions, but it also results in the perception that the proceedings were not open and transparent.

IEP has long recognized that certain data held by market participants are proprietary and, hence, should be deemed confidential by the agencies. However, the broad application of the “proprietary” shield that is all too often applied today is excessive and skews decision-making.

IEP recommends that the EAP II specifically address the following key matters: How do the agencies propose to achieve the “open, transparent” standards articulated in EAP II? To what extent is the principle of “comparable access” going to be applied? What rules, if any, will govern parties’ access to data deemed proprietary and, hence, confidential (e.g. what standardized Protective Order should apply across the various energy agencies)?

C. Need To Address Compliance Matters

Presently, two major energy resource policies are being implemented in California. One is the resource adequacy requirement (RAR). The second is the renewable portfolio standard (RPS). Both initiatives are characterized by (a) an obligation imposed on load serving entities (LSEs) subject to the CPUC’s authority, and (b) very time-consuming and litigious regulatory proceedings addressing implementation details.

In terms of RAR compliance, the first critical deadline is fall 2005, after the release of the RAR Phase II decision, when the “2006 showing” by the LSEs must be made as to whether they have forward-procured 90% of their RAR obligation. A second

critical deadline will be the 100% compliance showing 30 days in advance of each month. Finally, a third critical compliance date will be the ultimate showing, in an ex post manner, whether the LSEs had the resources to meet their peak demand (i.e. the ‘no black out’ test). In terms of RPS compliance, the LSEs must make a compliance showing that they have procured at least an incremental 1% of the annual energy sales for a year from certified renewables.¹ Second, LSEs pursuant to the action of the Joint Energy Agencies will be measured against a goal of achieving 20% of retail by renewable energy by the year 2010.

What is missing is clarification as to what sanctions, if any, an LSE will face for failing to meet its RAR or RPS obligations. The absence of regulatory agency action in this regard may be contributing to the endless litigation, as no regulatory “hammer” exists to compel resolution. While recognizing that the implementation details are important, compliance with the RAR and RPS obligations is knowable in the end (for example, the lights stayed on; a certain percentage of capacity contracts and/or tradable credits were purchased; a certain percentage of electricity was properly delivered during the year from certified renewable resources).

IEP recommends that the EAP II specifically address what sanctions will apply if individual LSEs fail to meet their RAR or RPS obligations. This will force the LSEs to plan more prudently and carefully now for the CPUC’s inevitable review of compliance to the RAR and RPS obligations in 2006 and beyond.

II. Comments on Specific Matters Addressed in Draft EAP II

A. Need to Recognize that Resource Sufficiency For Purposes of Reliability Is More Than Simply Counting Resources.

The CPUC’s implementation of the Resource Adequacy Requirement has slowed down while the parties have debated the details of a number of issues (e.g. what counts). In IEP’s view, the issue of what counts can be addressed more expeditiously if two bedrock principles guide the CPUC as it carries out its implementation of the RAR. The first principle is that the purpose of the RAR is to ensure that California has enough generation resources in the right locations to ensure the reliable delivery of electricity to customers, with only rare interruptions. The second principle is that decisions on the RAR must produce the result that is most likely to stimulate new investment in power plants at the right time and the right place. The current debates over the counting of resources for RAR purposes and other issues can be quickly resolved if these two key principles are followed.

IEP Recommends that the CPUC and CEC keep on pace to render the necessary Decisions to ensure that the Fall 2005 LSE RAR Compliance Filings (to ensure resource

¹ IEP recognizes the CPUC has designed and is implementing “flexible compliance” rules related to meeting the annual procurement target (APT) obligation.

adequacy during 2006) are made on time. This will require a RAR Phase II Decision in August 2005 at the latest, given the 90 days thereafter the LSEs have to make their compliance filings.

B. Compliance of the RPS Should Be Measured In Terms of Energy Delivered (Not Contracts)

The draft EAP II, under the heading “Accelerate the State’s Goal for Renewable Generation” [at Appendix A, p. 2], sets a goal of adding a net annual average of up to 600 MW of new renewable resources. As a status report, the draft EAP II states that the IOUs are expected to add 285-586 MWs of new renewable contracts with the potential for more.

The measure of RPS compliance is energy served, not a mere counting of the capacity behind the IOU executed contracts. This is a foundational element of the California RPS. Environmental improvement in the energy sector is realized through the delivery of clean energy to the grid, not through the execution of contracts which may or may not result in real energy delivered to the grid. The primary concern when contracts “entered into” are used as the metric for compliance, rather than electricity delivered, is that the potential exists for phantom projects to become the measure of compliance. In this sense, it creates the incentive for the utility to enter into contracts for compliance purposes with projects that have little if any chance of becoming operational. If compliance is measured as a percentage of annual energy sales to consumers, as intended by the legislature, then the LSEs have a stronger incentive to select projects that pass a viability/deliverability screen.

IEP Recommendation. The energy agencies should not allow LSEs subject to the RPS obligation to measure compliance of the RPS through the mere execution of contracts, nor should this metric be used in the EAP for (a) determining the status of implementation or (b) establishing goals going forward.

C. New Generation Resources

Under the heading “Ensure Reliable, Affordable Electricity Generation” [Appendix A, p.4], the draft EAP II states that since the adoption of the EAP in March 2003, over 8,000 MWs of new power plants have been permitted, over 6,000 MWs have become operational, and additional 1,380 MWs are expected online by July 2005. The EAP cites these statistics as a measure of program implementation and goal attainment.

First, IEP notes that many of these plants were sited and/or constructed prior to the energy crises. Thus, the role the EAP I has had in adding this new generation is uncertain. Second, because approximately 8,000 MWs of existing capacity remain uncontracted today for purposes of supplying needed capacity and/or energy to California’s LSEs, IEP questions whether sufficient resources can be counted as available to maintain the 15-18 percent reserve levels. Certainly, given this “hole” in the presumed availability of these resources for purposes of RAR compliance, the draft EAP II’s suggestion that actions in this area (e.g. “maintaining reserve levels in the 15-18 percent range) are “Achieved” is premature.

IEP Recommendation. First, it would be helpful to get a summary of the extent to which new generation facilities have begun the siting process since adoption of the EAP in March 2003, as this will help provide a measure of how successful recent state policies fostering new infrastructure development have really been. Second, the status for action item III (1) should be changed to “In Progress” rather than Achieved.

D. Gas Issues

Currently, the draft EAP II proposes to initiate a direction inconsistent with the record established in the CPUC’s Long-Term Natural Gas Supply proceeding (R.04-01-025). Under Section 6 Natural Gas Supply and Demand, Key Action item 5, the draft EAP II proposes to establish rules for emergency supply and backstop capacity for non-core customers. In that proceeding, however, a ruling was rendered that stated: “In this context, and in light of the positions of most parties in this proceeding, it does not appear useful to expressly and separately consider proposals for emergency reserves and backstop capacity at this time.” (p. 7) Rules such as this would probably be very costly, may not be justified on a cost-benefit basis, and may undermine the CPUC’s policy that requires non-core gas consumers to make their own arrangements for gas supply, interstate transportation and storage. In addition, such rules would create a significant potential for unintended consequences that would render them ineffective, just as the CEC found in rejecting the proposed emergency gasoline reserve in 2003.

IEP Recommendation. The CPUC should drop the emergency reserve idea completely, since it has already been considered and rejected. Alternatively, the CPUC should create a working group that monitors and reports to the CPUC on interstate pipeline market conditions.

E. Electricity Infrastructure

The draft EAP II correctly points out that “significant capital investments will be needed over the next decade to augment existing facilities, replace aging infrastructure and ensure that California’s electrical system can meet current and future needs at reasonable prices without over-reliance on a single fuel source” (draft EAP II, at p. 7). IEP applauds this recognition. What is missing from this section regarding Electricity Infrastructure is any mention of a critical problem with the existing infrastructure: namely, the absence of a contracting method available to existing facilities to repower, modernize, and otherwise be made available to help meet the state’s reliability and environmental objectives. For example, presently a number of existing Qualifying Facilities (QFs) are nearing the end of the term of their contracts. This is particularly acute for many cogeneration facilities. Similarly, an estimated 8,000 MWs of existing merchant facilities are unable to secure long-term contracts in today’s marketplace. Typically, they are not allowed to bid into the various RFOs circulated today. What this means is that much of the generation capacity, with a pre-existing footprint and typically located near load centers, is forced into a market void. This hinders investment, impairs reliability, and undermines many of the state’s efforts to improve the environmental performance of its generation fleet.

IEP Recommends that the EAP II specifically address how existing facilities with expiring contracts are to be addressed now and into the future. Will existing merchant generators with expired contracts or no contracts be allowed to compete in the future “all source” solicitations? Will QFs be able to exercise their PURPA rights to standard offer contracts that have a term sufficient in length to modernize the fleet? These are critical issues affecting the electricity infrastructure today.

IEP appreciates the opportunity to provide these comments to the Joint Energy Agencies involved with developing and implementing this important planning document.

Respectfully,

Steven Kelly
Policy Director

c.c. All Members of CPUC
All Members of CEC